EXHIBIT E-4

SONUS NETWORKS, INC.
Consolidated Balance Sheets
(In thousands, except share data)

	December 31, 2003	December 31, 2002 As Restated
Assets		
Current assets:		
Cash and cash equivalents	$ 133,715	$ 57,278
Marketable securities	171,677	60,860
Accounts receivable, net	23,754	4,622
Inventory, net	13,739	10,449
Other current assets	6,935	3,516
Total current assets	349,820	136,725
Property and equipment, net	5,009	11,546
Purchased intangible assets, net	2,402	4,810
Other assets	1,193	436
	$ 358,424	$ 153,517
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 3,248	$ 3,625
Accrued expenses	22,165	16,489
Accrued restructuring expenses	565	2,331
Current portion of deferred revenue	62,698	51,728
Current portion of long–term liabilities	182	1,606
Total current liabilities	88,858	75,779
Long–term deferred revenue, less current portion	24,302	8,024
Long–term liabilities, less current portion	829	3,293
Convertible subordinated note	10,000	10,000
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, $0.01 par value; 5,000,000 shares authorized, none issued and outstanding	—	—
Common stock, $0.001 par value; 600,000,000 shares authorized, 247,146,477 and 206,866,358 shares issued and 244,849,567 and 204,599,548 shares outstanding at December 31, 2003 and 2002	247	207
Capital in excess of par value	1,043,581	853,560
Accumulated deficit	(808,562)	(793,426)
Deferred compensation	(564)	(3,659)
Treasury stock, at cost; 2,296,910 and 2,266,810 common shares at December 31, 2003 and 2002	(267)	(261)
Total stockholders' equity	234,435	56,421
	$ 358,424	$ 153,517

The accompanying notes are an integral part of these consolidated financial statements.

SONUS NETWORKS, INC.
Consolidated Statements of Operations
(In thousands, except per share data)

	Year ended December 31, 2003	2002 As Restated	2001 As Restated
Revenues:			
Product	$ 60,851	$ 68,572	$ 104,646
Service	32,359	25,345	24,154
Total revenues	93,210	93,917	128,800
Cost of revenues (1):			
Write–off of inventory and purchase commitments	—	6,130	—
Product	23,575	33,573	43,717
Service	14,334	11,873	19,061
Total cost of revenues	37,909	51,576	62,778
Gross profit	55,301	42,341	66,022
Operating expenses:			
Research and development (1)	32,190	44,591	63,896
Sales and marketing (1)	23,169	27,786	40,876
General and administrative (1)	10,475	5,248	12,827
Stock–based compensation	3,418	16,871	74,132
Amortization of goodwill and purchased intangible assets	2,408	4,229	70,551
Write–off of goodwill and purchased intangible assets	—	10,950	392,387
Restructuring charges	—	7,739	7,321
In–process research and development	—	—	44,600
Total operating expenses	71,660	117,414	706,590
Loss from operations	(16,359)	(75,073)	(640,568)
Interest expense	(610)	(676)	(625)
Interest income	2,135	1,994	5,574
Loss before income taxes	(14,834)	(73,755)	(635,619)
Provision for income taxes	302	86	—
Net loss	$ (15,136)	$ (73,841)	$ (635,619)
Basic and diluted net loss per share	$ (0.07)	$ (0.39)	$ (3.68)
Shares used in computing net loss per share (Note 1 (q)):	220,696	191,008	172,905

(1) Excludes non–cash, stock–based compensation expense as follows:	2003	2002	2001
Cost of revenues	$ 45	$ 235	$ 1,304
Research and development	1,180	8,930	42,764
Sales and marketing	1,542	4,941	17,968
General and administrative	651	2,765	12,096
	$ 3,418	$ 16,871	$ 74,132

The accompanying notes are an integral part of these consolidated financial statements.

SONUS NETWORKS, INC.
Consolidated Statements of Stockholders' Equity

	Common Stock						Treasury Stock		
	Shares	Par Value	Capital in Excess of Par Value	Accumulated Deficit	Stock Subscriptions Receivable	Deferred Compensation	Shares	Cost	Total Stockholders' Equity
Balance, December 31, 2000	184,244,474	$ 184	$ 266,488	$ (83,966)	$ (238)	$ (31,697)	772,500	$ (65)	$ 150,706
Issuance of common stock in connection with employee stock purchase plan	1,021,333	1	7,865	—	—	—	—	—	7,866
Issuance of common stock in connection with acquisition of telecom technologies, inc. (TTI) (Note 5)	15,000,000	15	504,386	—	—	—	—	—	504,401
Issuance of common stock in connection with acquisition of certain assets of Linguateq, Inc. (Note 6)	221,753	—	4,843	—	—	—	—	—	4,843
Issuance of restricted stock awards in connection with acquisition of TTI (Note 5)	3,000,000	3	55,435	—	—	(55,438)	—	—	—
Deferred compensation related to unvested stock options assumed in connection with acquisition of TTI (Note 5)	—	—	22,600	—	—	(22,600)	—	—	—
Deferred compensation related to stock option grants	—	—	1,215	—	—	(1,215)	—	—	—
Compensation expense related to modifications of stock awards	—	—	438	—	—	—	—	—	438
Exercise of stock options	1,703,650	2	4,016	—	—	—	—	—	4,018
Amortization of deferred compensation	—	—	—	—	—	76,873	—	—	76,873
Deferred compensation for terminated employees	—	—	(8,181)	—	—	5,002	—	—	(3,179)
Payment on subscriptions receivable	—	—	—	—	238	—	—	—	238
Repurchase of common stock	—	—	—	—	—	—	241,250	(19)	(19)
Net loss	—	—	—	(635,619)	—	—	—	—	(635,619)
Balance, December 31, 2001 (As Restated)	205,191,210	205	859,105	(719,585)	—	(29,075)	1,013,750	(84)	110,566
Issuance of common stock in connection with employee stock purchase plan	1,199,247	2	2,841	—	—	—	—	—	2,843
Exercise of stock options	475,901	—	159	—	—	—	—	—	159
Amortization of deferred compensation	—	—	—	—	—	21,607	—	—	21,607
Compensation expense related to modifications of stock awards	—	—	190	—	—	—	—	—	190
Deferred compensation for terminated employees	—	—	(8,735)	—	—	3,809	—	—	(4,926)
Repurchase of common stock	—	—	—	—	—	—	1,253,060	(177)	(177)
Net loss	—	—	—	(73,841)	—	—	—	—	(73,841)
Balance, December 31, 2002 (As Restated)	206,866,358	207	853,560	(793,426)	—	(3,659)	2,266,810	(261)	56,421
Sale of common stock, net of issuance costs of $9,932	37,000,000	37	182,781	—	—	—	—		182,818
Issuance of common stock in connection with employee stock purchase plan	1,085,750	1	965	—	—	—	—	—	966
Exercise of stock options	2,194,369	2	5,952	—	—	—	—	—	5,954
Amortization of deferred compensation	—	—	—	—	—	3,039	—	—	3,039
Deferred compensation for terminated employees	—	—	(285)	—	—	56	—	—	(229)
Compensation expense related to issuance of common stock options to non-employees and modifications of stock awards	—	—	608	—	—	—	—	—	608
Repurchase of common stock	—	—	—	—	—	—	30,100	(6)	(6)
Net loss	—	—	—	(15,136)	—	—	—	—	(15,136)
Balance, December 31, 2003	247,146,477	$ 247	$ 1,043,581	$ (808,562)	$ —	$ (564)	2,296,910	$ (267)	$ 234,435

The accompanying notes are an integral part of these consolidated financial statements.

SONUS NETWORKS, INC.
Consolidated Statements of Cash Flows
(In thousands)

	Year ended December 31,		
	2003	2002	2001
		As Restated	As Restated
Cash flows from operating activities:			
Net loss	$ (15,136)	$ (73,841)	$ (635,619)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation	9,724	15,415	15,840
Write-off of inventory	—	6,130	—
Stock-based compensation	3,418	16,871	74,132
Amortization of goodwill and purchased intangible assets	2,408	4,229	70,551
Write-off of goodwill and purchased intangible assets	—	10,950	392,387
In-process research and development	—	—	44,600
Non-cash restructuring benefit	—	—	(16,557)
Changes in current assets and liabilities:			
Accounts receivable	(19,132)	6,059	51,013
Inventory	(3,290)	19,853	(8,571)
Other current assets	(3,419)	2,792	(233)
Accounts payable	(377)	(8,646)	(1,841)
Accrued expenses	3,381	(7,657)	18,356
Deferred revenue	27,248	(649)	(4,801)
Net cash provided by (used in) operating activities	4,825	(8,494)	(743)
Cash flows from investing activities:			
Net purchases of property and equipment	(3,187)	(3,418)	(23,190)
Maturities of marketable securities	19,538	58,524	75,984
Purchases of marketable securities	(130,355)	(43,440)	(96,971)
Other assets	(757)	(66)	(637)
Acquisitions, net of cash acquired	—	—	(6,058)
Net cash (used in) provided by investing activities	(114,761)	11,600	(50,872)
Cash flows from financing activities:			
Net proceeds from sale of common stock to public	182,818	—	—
Sale of common stock in connection with employee stock purchase plan	966	2,843	7,866
Proceeds from exercise of stock options	5,954	159	4,018
Payment of stock subscriptions receivable	—	—	238
Additions to long-term liabilities	—	3,300	—
Payments of long-term liabilities	(3,359)	(1,022)	(527)
Payment of note payable to bank	—	—	(8,000)
Proceeds from issuance of convertible subordinated note	—	—	10,000
Repurchase of common stock	(6)	(177)	(19)
Net cash provided by financing activities	186,373	5,103	13,576
Net increase (decrease) in cash and cash equivalents	76,437	8,209	(38,039)
Cash and cash equivalents, beginning of year	57,278	49,069	87,108
Cash and cash equivalents, end of year	$ 133,715	$ 57,278	$ 49,069

The accompanying notes are an integral part of these consolidated financial statements.

SONUS NETWORKS, INC.

Notes to Consolidated Financial Statements

(1) Operations and Significant Accounting Policies

Sonus Networks, Inc. (Sonus) was incorporated on August 7, 1997 and is a leading provider of voice infrastructure solutions for wireline and wireless service providers. Sonus offers a new generation of carrier–class switching equipment and software that enable voice services to be delivered over packet–based networks.

The accompanying consolidated financial statements reflect the application of certain significant accounting policies as described in this note and elsewhere in the accompanying consolidated financial statements and notes.

(a) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Sonus and its wholly owned subsidiaries. All material intercompany transactions and balances have been eliminated.

(b) Use of Estimates and Judgments

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates relied upon in preparing these financial statements include revenue recognition for multiple element arrangements, allowances for doubtful accounts, estimated fair value of investments, including whether any decline in such fair value is other–than–temporary, expected future cash flows used to evaluate the recoverability of long–lived assets, estimated fair values of long–lived assets used to record impairment charges related to intangible assets and goodwill, restructuring and other related charges, contingencies associated with revenue contracts, any contingent liabilities, and recoverability of Sonus' net deferred tax assets and related valuation allowance. Although Sonus regularly assesses these estimates, actual results could differ materially from these estimates. Changes in estimates are recorded in the period in which they become known. Sonus bases its estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances. Actual results may differ from Sonus' estimates if past experience or other assumptions do not turn out to be substantially accurate.

(c) Cash Equivalents and Marketable Securities

Cash equivalents are stated at cost plus accrued interest, which approximates market value, and have maturities of three months or less at the date of purchase.

Marketable securities are classified as held–to–maturity, as Sonus has the intent and ability to hold to maturity. Marketable securities are reported at amortized cost. Cash equivalents and marketable securities are invested in high quality credit instruments, primarily U.S. Government obligations and corporate obligations with contractual maturities of less than one year. There have been no material gains or losses to date.

(d) Concentrations of Credit and Off–Balance Sheet Risk, Significant Customers and Limited Suppliers

The financial instruments that potentially subject Sonus to concentrations of credit risk are cash, cash equivalents, marketable securities and accounts receivable. Sonus has no off–balance sheet

contracts such as foreign exchange contracts, options contracts or other foreign hedging arrangements. Sonus' cash and cash equivalent holdings are diversified among four financial institutions.

For the years ended December 31, 2003, 2002 and 2001, four, one and three customers, each of whom contributed more than 10% of revenues, accounted for an aggregate of 57%, 42% and 60% of revenues.

As of December 31, 2003 and 2002, four and three customers each accounted for an aggregate of 68% and 78% of Sonus' accounts receivable balance. Sonus performs ongoing credit evaluations of our customers and generally do not require collateral on accounts receivable. Sonus maintains an allowance for potential credit losses and such losses have been within management's expectations.

International revenues, primarily from Asia and Europe, were 21%, 18% and 23% of revenues for the years ended December 31, 2003, 2002 and 2001.

Certain components and software licenses from third parties used in Sonus' products are procured from a single source. The failure of a supplier, including a subcontractor, to deliver on schedule could delay or interrupt Sonus' delivery of products and thereby materially adversely affect Sonus' revenues and operating results.

(e) Foreign Currency Translation

Sonus' customer contracts are primarily denominated in U.S. dollars, and expenses denominated in foreign currencies are translated at average exchange rates for the period. For non–U.S. subsidiaries, which operate in a local currency environment, assets and liabilities are translated at period–end exchange rates. Translation adjustments were not material for any period presented.

(f) Unearned Accounts Receivable

Unearned accounts receivable represents products shipped to customers where Sonus has a contractual right to bill the customer and collectibility is probable prior to satisfying Sonus' revenue recognition criteria.

(g) Inventory

Inventory is stated at the lower of cost (first–in, first–out basis) or net realizable value and consists of final assembly materials and finished goods.

Unearned inventory represents deferred cost of revenues prior to satisfaction of Sonus' revenue recognition criteria.

(h) Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation. Expenditures for maintenance and repairs are charged to expense as incurred. Depreciation is computed using the straight–line method over the estimated useful life of the related assets, which range from three to five years. Leasehold improvements are amortized over the lesser of the life of the lease or five years. When an item is sold or retired, the cost and related accumulated depreciation is relieved, and the resulting gain or loss, if any, is recognized in the statement of operations.

(i) Goodwill and Purchased Intangible Assets

In June 2001, the FASB issued SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 142 eliminated the amortization of goodwill and certain other intangibles with indefinite lives and instead subjects these assets to periodic impairment assessments. SFAS No. 142 was effective for all goodwill and certain other intangibles acquired after June 30, 2001 and commenced on January 1, 2002 for all goodwill and certain other intangibles existing on June 30, 2001.

In accordance with SFAS No. 144, the carrying value of intangible assets and other long–lived assets is reviewed on a regular basis for the existence of facts or circumstances, both internally and externally, that may suggest impairment. Factors Sonus considers important which could trigger an impairment review include:

- Significant underperformance relative to historical or projected future operating results;
- Significant negative industry or economic trends;
- Significant change in circumstances relative to a large customer;
- Significant decline in Sonus' stock price for a sustained period; and
- Sonus' market capitalization relative to Sonus' net book value.

If such circumstances exist, Sonus evaluates the carrying value of long–lived assets, other than goodwill, to determine if impairment exists based upon estimated undiscounted future cash flows over the remaining useful life of the assets and comparing that value to the carrying value of the assets. In determining expected future cash flows, assets are grouped at the lowest level for which cash flows are identifiable and independent of cash flows from other asset groups. If the carrying value of the asset is greater than the estimated future cash flows, the asset is written down to estimated fair value. The estimated future cash flows and valuation of long–lived assets requires significant estimates and assumptions, including revenue and expense growth projections and fair value estimates, such as estimated replacement cost and relief from royalty. The estimates contain management's best estimates, using appropriate and customary assumptions and projections at the time.

Purchased intangible assets of $2,402,000 as of December 31, 2003 are carried at cost less accumulated amortization. Amortization is computed over the estimated useful lives of the respective assets. Sonus expects that the remaining amount of purchased intangible assets will be fully amortized by December 2004.

(j) Other Assets

Other assets are deposits for leased facilities.

(k) Revenue Recognition

Sonus recognizes revenues from product sales when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility of the related receivable is probable, unless Sonus has future obligations, including a requirement to deliver additional elements which are essential to the functionality of the delivered elements or for which vendor specific objective evidence of fair value (VSOE) does not exist or customer acceptance is required, in which case the revenues and related costs are deferred until those obligations are satisfied or contingencies are resolved.

Many of Sonus' sales are generated from complex contractual arrangements, which require significant revenue recognition judgments, particularly in the case of multiple element arrangements. When a sale involves multiple elements, such as products, maintenance or professional services, Sonus allocates the entire sales price to each respective element based on VSOE or using the residual method when VSOE cannot be established for one of the delivered elements in the arrangement. Sonus then recognizes revenues on each element in accordance with its policies for product and service revenue recognition. Sonus determines VSOE based upon the price charged when the same element is sold separately. If Sonus cannot establish VSOE for each undelivered element, it defers the entire contract revenues until the earlier of the establishment of VSOE or delivery of the undelivered element.

In addition, if an arrangement with a customer includes a specified upgrade right for which VSOE cannot be established, Sonus defers all revenue related to the arrangement until the earlier of the delivery of the specified upgrade or the establishment of VSOE for the specified upgrade. In determining whether a specified upgrade right exists, Sonus has concluded that if the specified upgrade is included in the customer contract or otherwise becomes part of the arrangement with the customer, then a specified upgrade right exists. Sonus has concluded that communications with customers in the normal course of business regarding customer feature requests and Sonus' product plans do not create specified upgrade rights.

Maintenance and support services are recognized ratably over the life of the maintenance and support service period, which typically is one year when the services are sold separately and up to five years when bundled with the product fees. Maintenance and support services include telephone support and unspecified rights to product upgrades and enhancements. These services are typically sold for a one–year term and either are sold as part of a multiple element arrangement with products or are sold independently at time of renewal. Maintenance and support VSOE represents a consistent percentage of the sales prices charged to customers. The application of judgment could affect the continued determination of maintenance VSOE and our ability to recognize revenue using the residual method.

Installation service revenues are typically recognized at the time of the related product revenue recognition as installation is typically complete by the time of product revenue recognition. Professional services are recognized as the services are performed.

Sonus sells the majority of its products directly to end–users. For products sold through resellers and distributors Sonus recognizes revenues on a sell–through method utilizing information provided to it from its resellers and distributors.

Product shipped to customers and related services where amounts are (1) billed pursuant to a contractual right and collection is probable, or (2) collected prior to satisfying the revenue recognition criteria are reflected as deferred revenues. Deferred revenues also include customer deposits and amounts associated with maintenance contracts, which are recognized on a straight–line basis over the related service periods, and free or discounted products and services not yet provided to customers. Deferred revenues not expected to be recognized within one year of the balance sheet date are classified as long–term deferred revenues.

Sonus defers any incremental direct costs, such as inventory, royalties, commissions and third–party installation costs, incurred prior to satisfaction of its revenue recognition criteria and records them in proportion to revenue recognized.

(l) Software Development Costs

Sonus accounts for its software development costs in accordance with SFAS No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed.* Accordingly, the costs for the development of new software and substantial enhancements to existing software are expensed as incurred until technological feasibility has been established, at which time any additional costs would be capitalized. Sonus has determined that technological feasibility is established at the time a working model of the software is completed. Because Sonus believes its current process for developing software is essentially completed concurrently with the establishment of technological feasibility, no costs have been capitalized to date.

(m) Stock–based Compensation

In October 1995, the FASB issued SFAS No. 123, *Accounting for Stock–Based Compensation.* SFAS No. 123 provides that companies may account for stock–based compensation under either the fair value–based method of accounting under SFAS No. 123 or the intrinsic value–based method provided by APB No. 25, *Accounting for Stock Issued to Employees.* Sonus uses the intrinsic value–based method of APB No. 25 to account for all of its employee stock–based compensation plans and uses the fair value method of SFAS No. 123 to account for all non–employee stock–based compensation. Sonus follows FIN 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans* and amortizes the intrinsic value for all awards as measured under APB No. 25 on an accelerated basis. SFAS No. 123, as amended by SFAS No. 148, *Accounting for Stock–Based Compensation—Transition and Disclosure—an amendment of FASB Statement No. 123,* requires companies following APB No. 25 to make pro forma disclosure in the notes to the consolidated financial statements using the measurement provisions of SFAS No. 123.

Sonus has computed the pro forma disclosures required under SFAS No. 123 for stock options granted to employees and shares purchased under the 2000 Employee Stock Purchase Plan (ESPP) using the Black Scholes option–pricing model. In valuing the stock options granted, Sonus used an assumed risk–free interest rate of 3% for both 2003 and 2002 and 4.5% for 2001, volatility of 137% for 2003 and 150% for both 2002 and 2001 and an expected life ranging from three to five years, with the assumption that dividends will not be paid. In valuing the ESPP, Sonus used an assumed risk–free interest rate of 1.1%–4.7% for 2003, 1.6%–6.8% for 2002 and 3.4%–6.6% for 2001, volatility of 137%–150% for 2003 and 80%–150% for 2002 and 2001 and an expected life ranging from six months to two years, with the assumption that dividends will not be paid. The pro forma information is as follows:

	Year ended December 31,		
	2003	2002	2001
		As Restated	As Restated
	(in thousands, except per share data)		
Net loss—			
As reported	$ (15,136)	$ (73,841)	$ (635,619)
Plus: Employee stock–based compensation expense included in net loss under intrinsic value method related to options	2,589	6,109	17,730
Less: Employee stock–based compensation under fair value method	(43,404)	(46,116)	(46,014)
Pro forma	$ (55,951)	$ (113,848)	$ (663,903)
Basic and diluted net loss per share—			
As reported	$ (0.07)	$ (0.39)	$ (3.68)
Pro forma	(0.25)	(0.60)	(3.84)

(n) Comprehensive Loss

Sonus applies SFAS No. 130, *Reporting Comprehensive Income*. The comprehensive loss for the years ended December 31, 2003, 2002 and 2001 does not differ from the reported loss.

(o) Fair Value of Financial Instruments

The carrying amounts of Sonus' financial instruments, which include cash equivalents, marketable securities, accounts payable, long–term liabilities and the convertible subordinated note, approximate their fair value.

(p) Disclosures about Segments of an Enterprise

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, established standards for reporting information regarding operating segments and established standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker in making decisions regarding resource allocation and assessing performance. To date, the chief operating decision maker has made such decisions and assessed performance at the company level.

(q) Net Loss Per Share

Basic loss per share is based on the weighted average number of unrestricted common shares outstanding during the period. Diluted loss per share reflects the per share effect of dilutive common stock equivalents, including common stock issuable upon the exercise of stock options, conversion of convertible subordinated notes and shares of common stock issued in connection with our acquisition of telecom technologies, inc. (TTI), which were subject to the achievement of milestones and employee retention (Notes 5 and 14(f)). Common stock equivalents at December 31, 2003, 2002 and 2001 were not included in the computation of diluted loss per share because Sonus recorded losses for each of the years then ended.

The following table sets forth the computation of shares used in calculating the basic and diluted net loss per share, in thousands:

	Year ended December 31,		
	2003	2002	2001
		As Restated	As Restated
Weighted average common shares outstanding	224,529	203,358	198,581
Less weighted average restricted common shares outstanding	(3,833)	(12,350)	(25,676)
Shares used in computing basic and diluted net loss per share	220,696	191,008	172,905

Excluded from the computation of diluted net loss per share in the above table are options to purchase shares of common stock and shares of common stock issuable upon conversion of convertible subordinated notes representing an aggregate of 28,469,634, 12,746,113 and 20,748,200 as of December 31, 2003, 2002 and 2001, as their effects would have been anti–dilutive.

(r) Loss Contingencies

Loss Contingencies. Sonus is subject to ongoing business risks that affect the estimation process of the carrying value of assets, the recording of liabilities and the possibility of various loss contingencies, arising in the ordinary course of business. Under SFAS No. 5, an estimated loss contingency is accrued when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. Sonus regularly evaluates current information available to it to determine whether such amounts should be adjusted. Based on Sonus' analysis, it has established the following allowance and reserves:

Allowance for Doubtful Accounts. Sonus establishes billing terms at the time it negotiates purchase agreements with its customers. Sonus continually monitors timely payments and assesses any collection issues. The allowance for doubtful accounts is based on Sonus' detailed assessment of the collectibility of specific customer accounts. While Sonus believes that its allowance for doubtful accounts is adequate and that the judgment applied is appropriate, if there is a deterioration of a customer's creditworthiness or actual defaults are higher than historical experience, the actual results could differ from these estimates. While such credit losses have historically been within Sonus' expectations and the allowances that have been established, Sonus cannot guarantee that it will continue to experience the same credit loss rates that it has in the past. If the financial condition of Sonus' customers were to deteriorate, resulting in an impairment of their ability to make payment, additional allowances may be required. Sonus' failure to accurately estimate the losses for doubtful accounts and ensure that payments are received on a timely basis could have a material adverse effect on its business, financial condition and results of operations.

Inventory Reserves. Inventory purchases and commitments are based upon estimated future demand for Sonus' products. Sonus values inventory at the lower of cost or net realizable value and provides inventory reserves based on excess and obsolete inventory determined primarily by future demand forecasts and records changes to such reserves through adjustments to cost of revenues. Sonus assesses such demand forecasts on at least a quarterly basis. If Sonus records a charge to reduce inventory to its estimated net realizable value, Sonus cannot increase its carrying value due to subsequent changes in demand forecasts. Accordingly, if inventory previously written down to its net realizable value is subsequently sold, Sonus may realize improved gross profit margins on those transactions.

Sonus also records a full inventory reserve for evaluation equipment at the time of shipment to its customers as a charge to sales and marketing expense as Sonus' experience with this type of inventory indicates it is probable that the inventory will not be realizable. If these evaluation shipments should convert to revenue, Sonus records a benefit to sales and marketing expense and records the full cost of revenues in the period of revenue recognition.

Sonus has experienced significant changes in its product demand and, as a result, its required inventory reserves have fluctuated in recent periods. As of December 31, 2003 and 2002, inventory of $13.7 million and $10.4 million, was net of reserves of $13.8 million and $18.3 million. It is possible that significant changes in required inventory reserves may continue to occur in the future if there is a sudden and significant change in the demand for Sonus' products, changes in the amount of customer evaluation inventory or higher risks of inventory obsolescence because of rapidly changing technology.

Warranty Reserve. Sonus' products are covered by a standard warranty of 90 days for software and one year for hardware. In addition, certain customer contracts include warranty–type provisions for epidemic or similar product failures generally for the contractual period or the life of the product in accordance with published telecommunications standards. Sonus accrues for such contingent obligations when the occurrence of such obligation is probable and the amount of such obligation is reasonably estimable. Sonus has not incurred significant costs related to such provisions. Sonus' customers typically purchase maintenance and support contracts, which encompass its warranty obligations. Sonus' warranty reserve reflects estimated material and labor costs for potential or actual product issues in its installed base that are not covered under maintenance contracts but for which Sonus expects to incur an obligation. Sonus' estimates of anticipated rates of warranty claims and costs are primarily based on historical information and future forecasts.

In addition, certain of our customer contracts include provisions under which we may be obligated to pay penalties generally for the contractual period or the life of the product if our products fail or do not perform in accordance with specifications. Sonus accrues for such contingent obligations when the occurrence of such obligation is probable and the amount of such obligation is reasonably estimable. Sonus has not incurred significant costs related to such provisions. Sonus periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. While Sonus believes its warranty reserve is adequate to address known warranty issues, an increase in product failures rates, material usage or service delivery costs may result in an increase to its warranty reserve and gross profit could be adversely affected.

Royalty Accrual. Sonus accrues for royalties related to technology it licenses from vendors based on established royalty rates and usage. In certain cases, Sonus has been contacted by third parties, who claim that Sonus' products infringe on certain intellectual property of the third party. Sonus evaluates these claims and accrues for royalties when the amounts are probable and reasonably estimable. While Sonus believes that the amounts accrued for estimated royalties are adequate, the amounts required to ultimately settle royalty obligations may be different.

Reserve for Litigation and Legal Fees. Sonus is subject to various legal claims, including securities litigation and intellectual property claims. Sonus reserves for legal contingencies and legal fees when the amounts are probable and reasonably estimable. Sonus' director and officer liability insurance policies provide only limited liability protection relating to the securities class action and derivative lawsuits against Sonous and certain of its officers and directors. Sonus intends to defend these matters vigorously, although the ultimate outcome of these items is uncertain and the potential loss, if any, may be significantly higher or lower than the amounts Sonus has previously accrued.

(s) Recent Accounting Pronouncements

In November 2002, the FASB issued FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.* FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of the interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002 and the disclosure requirements in this interpretation are effective for financial statements of interim or annual

periods ending after December 15, 2002. The FIN 45 disclosure requirements are included in Note 8(c). The adoption of FIN 45 did not have a material impact on Sonus' financial position or results of operations.

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities* and, in December 2003, issued a revision to that interpretation (FIN 46R). FIN 46R replaces FIN 46 and addresses consolidation by business enterprises of variable interest entities that possess certain characteristics. A variable interest entity (VIE) is defined as (a) an ownership, contractual or monetary interest in an entity where the ability to influence financial decisions is not proportional to the investment interest, or (b) an entity lacking the invested capital sufficient to fund future activities without the support of a third party. FIN 46R establishes standards for determining under what circumstances VIEs should be consolidated with their primary beneficiary, including those to which the usual condition for consolidation does not apply. Sonus currently does not have any variable interest entities.

In May 2003, the FASB issued SFAS No. 150, *Accounting For Certain Financial Instruments with Characteristics of Both Liabilities and Equity,* which establishes standards for how an issuer of financial instruments classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have any impact on Sonus' overall financial position or results of operations.

In August 2003, the EITF reached a consensus on Issue No. 03–05, *Applicability of AICPA Statement of Position 97–2 to Non–Software Deliverables in an Arrangement Containing More–Than–Incidental Software.* EITF Issue No. 03–05 addresses the applicability of SOP 97–2 to non–software deliverables in an arrangement containing more–than–incidental software. In an arrangement that includes software that is more–than–incidental to the products or services as a whole, software and software–related elements are included within the scope of SOP 97–2. Software–related elements include software products and services, as well as any non–software deliverables for which a software deliverable is essential to its functionality. The adoption of this statement did not have a material impact on Sonus' consolidated financial statements.

In December 2003, the staff of the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 104 (SAB 104), *Revenue Recognition,* which supersedes SAB No. 101, *Revenue Recognition in Financial Statements.* SAB No. 104's primary purpose is to rescind the accounting guidance contained in SAB No. 101 related to multiple–element revenue arrangements that was superseded as a result of the issuance of EITF Issue No. 00–21, *Accounting for Revenue Arrangements with Multiple Deliverables.* Additionally, SAB No. 104 rescinds the SEC's related *Revenue Recognition in Financial Statements Frequently Asked Questions and Answers* issued with SAB No. 101 that had been codified in SEC Topic 13, *Revenue Recognition.* While the wording of SAB No. 104 has changed to reflect the issuance of EITF Issue No. 00–21, the revenue recognition principles of SAB No. 101 remain largely unchanged by the issuance of SAB No. 104, which was effective upon issuance. Sonus adopted the provisions of SAB No. 104 in the fourth quarter of 2003. Sonus' adoption of SAB No. 104 did not have a material effect on its financial position or results of operations.

(2) Restatement of Consolidated Financial Statements

In connection with certain matters which were identified in January through March 2004, Sonus determined that the accounting with respect to certain prior period transactions required adjustment. As a result, Sonus has restated its consolidated financial statements for the years ended December 31, 2002 and 2001. The restated financial statements include a number of adjustments which primarily relate to revenue, deferred revenue, inventory reserves, purchase accounting, impairments, accrued expenses and stock–based compensation. Adjustments to revenue result in revenue being deferred and recognized in subsequent periods. Adjustments to inventory and accrued expenses are primarily to increase or decrease reserve levels previously reported. Adjustments to purchase accounting, impairment, and stock–based compensation relate primarily to the timing of expense recognition.

The net effects of all of the restatement adjustments on the statements of operations, and on all the balance sheet accounts, as of the dates and for the periods indicated are as follows, in thousands, except per share data:

	As of or for the year ended Dec. 31, 2002	As of or for the year ended Dec. 31, 2001
Consolidated Statement of Operations Data:		
Increase (decrease) in revenue	$ 31,359	$ (44,399)
(Increase) decrease in loss before income taxes	(5,285)	9,813
(Increase) decrease in net loss	(5,371)	9,813
(Increase) decrease in net loss per share	$ (0.03)	$ 0.06
Consolidated Balance Sheet Data:		
Increase (decrease) in cash and cash equivalents	$ 6,971	$ (54)
Increase (decrease) in accounts receivable	1,666	1,241
Increase (decrease) in inventory	(327)	11,437
Increase (decrease) in other current assets	(290)	3,356
Increase (decrease) in goodwill and purchased intangible assets, net	3,636	15,453
Increase (decrease) in all other assets	328	(111)
Increase (decrease) in accounts payable	(517)	3,641
Increase (decrease) in accrued expenses	(16,890)	(9,225)
Increase (decrease) in accrued restructuring expenses	(812)	(17,344)
Deferred Revenue:		
Increase (decrease) in current portion of deferred revenue	22,493	43,110
Increase (decrease) in long–term deferred revenue	8,024	3,942
Total increase (decrease) in deferred revenue	$ 30,517	$ 47,052
Increase (decrease) in current portion of long–term liabilities	$ —	$ (483)
Increase (decrease) in stockholders' equity	(314)	7,681

The following discussion provides additional information regarding these adjustments.

Revenue Adjustments

Deferral of product revenue

Sonus has deferred revenues of $36.7 million previously reported in 2001 from a particular customer transaction. The amount of $27.5 million was subsequently recognized in the second quarter of 2002, while the remainder was allocated to maintenance revenues and recognized over the period the services are provided. This transaction involved a multiple element arrangement. Sonus previously recognized revenue in 2001 under this contractual arrangement upon delivery and acceptance of certain product and software releases. Sonus has now determined that there was insufficient support to establish vendor specific objective evidence of fair value (VSOE) with respect to certain undelivered software releases and determined the existence of certain previously unidentified specified software releases. As a result, Sonus has deferred product revenues associated with the products and software releases shipped to this customer in 2001 until the second quarter of 2002, when all software releases under the arrangement were delivered.

In the fourth quarter of 2002, Sonus amended its arrangement with this customer to include, among other items, certain additional future software releases. Sonus has determined that VSOE of fair value did not exist for certain undelivered software releases. As a result, Sonus has deferred revenue of $16.2 million associated with products and software releases shipped to this customer during the fourth quarter of 2002 and the first three quarters of 2003. Sonus recognized $10.9 million of those revenues in the fourth quarter of 2003 when the final software release specified in the amendment was delivered to the customer, and the remaining amount was deferred and allocated to maintenance services and estimated discounts on future purchases.

Maintenance revenue

A number of our customer transactions involve multiple elements, including the delivery of product and maintenance services as part of a bundled offering. Statement of Position (SOP) 97–2, *Software Revenue Recognition*, requires maintenance revenue to be recognized over the period services are provided. Sonus identified certain circumstances in which it offered maintenance services at no additional charge or at discounted rates to certain customers but did not separate the fair value for the maintenance from product revenue. This resulted in revenue associated with the value of the undelivered maintenance services not being recognized over the service period. In the restated financial statements, Sonus has recognized maintenance revenues ratably over the period in which the maintenance services were provided based on the deferral of the applicable VSOE of maintenance services. In such cases, Sonus has reclassified maintenance services from product revenue to service revenue for the applicable periods presented. Sonus also identified certain circumstances in which insufficient value was allocated to maintenance. In such cases, Sonus has reclassified additional amounts from product revenue to service revenue for the applicable periods presented. In connection with the recognition of the deferred product revenue described above in 2002 and 2003, a significant portion of the product revenue was allocated to the value of undelivered maintenance services and deferred over the five–year period in which the services are being provided.

Delivery

Sonus identified transactions where it delivered some, but not all, of the product required under an arrangement. Previously, Sonus deferred a portion of the revenue for these undelivered products